We have also prescribed a 12.2 percent rate of return for AT&T, but that rate of return is no longer used in interstate ratemaking.[69]

67. We believe that we should continue to limit the return on investment carriers include in affiliate transactions costs. We also believe that the advantages of having a single rate of return for all non-average schedule LECs to use in calculating those costs outweigh any possible disadvantages of that approach. Since those LECs' rates are based on the 11.25 percent rate of return prescribed for LEC interstate access service,[70] we propose to require all non-average schedule LECs to use that rate of return in calculating affiliate transactions costs. We also propose to require AT&T and Alascom to calculate their affiliate transactions costs using the 12.2 percent rate of return most recently prescribed for AT&T.[71]

68. In making these proposals, we recognize that our regulation of LECs has changed dramatically since the adoption of the affiliate transactions rules. These changes have resulted in a continuum of regulatory approaches ranging from traditional, rate of return regulation to price caps.[72] We invite the commenters to address whether we should vary the rate of return used in calculating affiliate transactions costs, depending on how we regulate the individual LEC.

69. For instance, our LEC price cap program defines two permissible earnings ranges for price cap LECs: one extending from 10.25 percent to 14.25 percent for LECs electing the 3.3 percent productivity offset, the other extending from 10.25 percent to

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(D.C. Cir. Apr. 2, 1993).

[69] See Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers, Report and Order, CC Docket No. 84-800, Phase III, 51 Fed. Reg. 32920, slip op. at 48, para. 88 (Sept. 17, 1986), recon. 2 FCC Rcd 5636 (1987). We have not prescribed a rate of return for Alascom.

[70] Although price cap LECs are no longer regulated on a rate of return basis, their initial price cap indexes were based on the prescribed 11.25 percent rate of return.

[71] AT&T's initial price cap indexes were based on this prescribed rate of return. We note that para. 101, infra, invites comment on whether we should subject AT&T to each aspect of our proposed system, including our proposal to limit the rate of return carriers can earn on those affiliate transactions required to be recorded at cost.

[72] Regulatory Reform Order, 8 FCC Rcd at 4545-46, paras. 4-6; LEC Price Cap Order, 5 FCC Rcd at 67867, paras. 1-5; AT&T Price Cap Order, 4 FCC Rcd at 2893, paras. 38-39.

15.25 percent for LECs electing the 4.3 percent productivity offset.[73] By defining these earnings ranges in terms of specific percentages, rather than through reference to a prescribed rate of return, this system detaches price cap LECs from rate of return regulation. In these circumstances, we invite comment on whether we should require price cap LECs to compute their affiliate transactions costs using rates of return from within these ranges other than the rate of return prescribed for LEC interstate access service and, if so, what rates of return we should require. We request that the commenters address, in particular, whether we should pick percentages that reflect the rate of return on interstate access service each price cap LEC actually achieves after sharing.

70. Similarly, Section 61.50 of our rules[74] permits non-price cap LECs that elect optional incentive regulation to retain earnings up to 150 basis points (1.5 percent) above the rate of return prescribed for LEC interstate access service. LECs electing this form of regulation must file tariffs for two-year periods. During that period, LECs may increase the tariffed rates only to the extent necessary to produce earnings 75 basis points (0.75 percent) below the rate of return prescribed for LEC interstate access service. We invite the commenters to address whether we should require optional incentive regulation LECs to compute their affiliate transactions costs using rates of return from within this minus 75 basis points/plus 150 basis point range other than the rate of return prescribed for LEC interstate access service and, if so, what rates of return we should pick. We request that the commenters address, in this regard, whether for each LEC operating under optional incentive regulation we should pick a percentage that reflects that LEC's actual interstate earnings as well as the methodology we should use to measure those earnings.

71. Finally, the rate of return we prescribe for LEC interstate access service may differ from the rates of return states prescribe or authorize for intrastate telecommunications services. Since affiliate transactions support intrastate as well as interstate services, we invite comment on whether we should

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[73] LEC Price Cap Order, 5 FCC Rcd 6801-02, paras. 123-27. More specifically, price cap LECs may increase their interstate rates to the extent necessary to earn a 10.25 percent interstate rate of return. LECs electing the 3.3 percent productivity offset may retain all interstate earnings up to 12.25 percent, 50 percent of interstate earnings between 12.25 percent and 16.25 percent, and no interstate earnings above 16.25 percent. LECs electing the 4.3 percent productivity offset may retain all interstate earnings up to 13.25 percent, 50 percent of interstate earnings between 13.25 percent and 17.25 percent, and no interstate earnings above 17.25 percent. Id.

[74] Regulatory Reform Order, 8 FCC Rcd at 4565-66, to be codified at 47 C.F.R. §61.50.

require or permit any LEC to determine the return component of affiliate transactions costs using a composite of the prescribed, interstate rate of return and the intrastate rates of return prescribed or authorized for that LEC. We also invite comment on how this composite should be calculated and on whether the benefits of this approach would exceed the additional burden of such calculations. We ask the commenters to discuss whether this approach would improperly delegate to state regulators our authority over federal accounting matters.

d. Expenses

72. We propose to make clear that carriers must include operating expenses, depreciation and amortization expense, taxes, and reasonable charitable contributions in their cost calculations for those affiliate transactions that our proposed valuation methods would require carriers to record at cost. We also propose to require that those calculations reflect any interest related to customer deposits apportioned to affiliate transactions, and exclude gains and losses similar to those that our rules exclude from the calculation of carrier net income.

73. The gains and losses we propose to exclude fall into three categories. First, our rules require carriers to treat gains related to property sold to others and leased back under capital leases for use in telecommunications services as a deferred credit to be amortized over the amortization periods established in the leases.[75] We propose to require carriers to treat property involved in sale/lease back transactions in an identical manner in calculating affiliate transactions costs.

74. Second, our rules allow gains and losses related to the disposition of nondepreciable land and artworks to be included in carrier net income, but only to the extent they were used in regulated operations and included in the interstate rate base.[76] We propose to require the inclusion of such gains and losses in affiliate transactions costs to the extent and only to the extent the related land or artworks supported affiliate transactions. We propose, in addition, that carriers calculate the extent of that support by applying the ratio of each affiliate's revenue from affiliate transactions for the period during which the affiliate owned the land or artworks to the affiliate's total revenue for that period.

75. Third, absent a specific Commission determination that particular items should be included, our rules require carriers to exclude nonoperating income and expenses, such as dividends on

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[75] 47 C.F.R. §65.450(b)(1).

[76] 47 C.F.R. §65.450(b)(2).

stock investments and income from sinking funds, and extraordinary items, such as extraordinary income credits and charges, from their net income calculations.[77] We propose an identical approach with regard to the calculation of affiliate transactions costs.

76. We invite comment on each of these proposals and on whether we should exclude other items from affiliate transactions costs. We also invite comment on whether we should impose this expense methodology on all carriers subject to the affiliate transactions rules, rather than on only AT&T and those LECs whose annual revenues total at least $100 million.[78]

5. Estimating, Monitoring, and True-up Procedures

77. The methodologies we propose for determining affiliate transactions costs require accurate information regarding the ongoing operations of carriers and their nonregulated affiliates. Since that information is not always available as transactions occur, we believe that carriers should maintain procedures for estimating affiliate transactions costs, monitoring the estimates' accuracy, and truing-up if they prove inaccurate. We propose to require carriers to use the methods described below in performing these functions. We invite comment on these methods.

78. First, we propose to require carriers to maintain procedures for estimating the costs of affiliate transactions. In many instances, the best source of information on those costs will be company budgets that reveal, among other matters, the costs each carrier and nonregulated affiliate anticipates it will incur, the kinds of transactions in which it intends to engage, and the expected volume of those transactions. This and similar information should allow carriers to estimate affiliate transactions costs. We propose to require carriers to use these estimates to record affiliate transactions in USOA accounts as they occur.

79. Second, as volume deviates from expectations and other operational changes occur, a carrier's good faith estimates could become inaccurate. We propose to require carriers to monitor the accuracy of their estimates by periodically comparing them with actual results. If a deviation occurs, we believe that carriers should have to update their estimates for use in recording future

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[77] 47 C.F.R. §65.450(d). The exclusion for nonoperating income and expenses does not apply to reasonable charitable contributions or interest related to customer deposits.

[78] We note that para. 101, infra, invites comment on whether we should subject AT&T to each aspect of our proposed system, including our proposal to specify an allowable expense methodology for use in calculating affiliate transaction costs.

affiliate transactions. We propose that this updating occur quarterly.

80. Third, if actual costs deviate from estimates, we believe that carriers should be required to true-up their books to eliminate any discrepancies. We propose to require that the truing-up process be completed prior to closing the carrier's books for the year in which the transactions took place, but we invite comment on whether a different truing-up schedule should be required to accommodate transactions occurring close to the end of the year. We also propose to use the one-year period covered by the carrier's books to measure compliance with our affiliate transactions rules.

81. We propose, in addition, to require carriers to retain documentation showing how these estimating, monitoring, and truing-up procedures are performed.

B. Prevailing Company Prices

1. 75 Percent Test

82. This Notice proposes to restrict prevailing company pricing to affiliate transactions in which the nonregulated affiliate sells at least 75 percent of its output to non-affiliates.[79] We invite comment on two alternatives for measuring that output that we describe below.

83. The first alternative would require carriers to measure each nonregulated affiliates's output using its actual revenues during the year for which affiliate transactions are to be valued. If we adopt this alternative, we intend to help assure ongoing compliance by requiring carriers to project annually whether each of their nonregulated affiliates will meet or exceed the 75 percent mark during the upcoming year. We also propose that the initial revenue projections assume that all affiliate transactions will be provided at cost. Thereafter, carriers would follow one of two approaches, depending on the results of the initial projections. If the nonregulated affiliate being considered were projected to fall short of the 75 percent mark during the upcoming year, the carrier would value the nonregulated affiliate's sales to affiliates at the lower of fully distributed costs and estimated fair market value as proposed in this Notice. If the nonregulated affiliate were projected to meet or exceed the 75 percent mark during the upcoming year, the carrier would value at least some of the nonregulated affiliate's sales to affiliates at prevailing

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[79] See paras. 15-22, supra.

company prices.[80]

84. The approach described above would continue until updated projections or actual data change the results of the 75 percent test for the nonregulated affiliate in question. In addition, the final accounting entries for the year would be based on actual, rather than projected, data.

85. The second alternative would require carriers to measure output using the nonregulated affiliate's revenues from the immediately preceding year. If we adopt this alternative, we propose to require carriers to apply the existing valuation methods to determine whether each of their nonregulated affiliates had sold at least 75 percent of their output to non-affiliates during the calendar year immediately preceding the year any new valuation methods become effective. The results of these determinations would be applied throughout the year in which the new valuation methods take effect. Thereafter, carriers would use the new valuation methods to reevaluate annually whether its nonregulated affiliates meet or exceed the 75 percent mark. Under this approach, the final accounting entries for any given year would be based on historical data for the preceding year.

2. Other Potential Conditions

86. Under our current rules, a carrier must provide substantial quantities of an asset or service to non-affiliates in order to be eligible for prevailing company pricing.[81] We believe that this product-by-product approach might be unduly restrictive if we adopt the proposed 75 percent test. Therefore, we invite comment on whether we should provide for prevailing company pricing on another basis, such as a product line, line of business, or total company basis.

87. Under a product line approach, each affiliate that engages in affiliate transactions with a nonregulated affiliate that meets the 75 percent test would be divided into product lines. An affiliate transaction would be eligible for prevailing company pricing only if the providing affiliate also provided one or more products within the same product line to non-affiliates. Under a line of business approach, each affiliate that engages in affiliate

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[80] In paragraphs 86-89, infra, we invite comment on whether carriers should record at prevailing company prices all, rather than only a portion, of their transactions with nonregulated affiliates that meet or exceed the 75 percent mark.

[81] See Joint Cost Reconsideration Order, 2 FCC Rcd at 6296, para. 120; see also U S West's Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs, 2 FCC Rcd 195, 199, paras. 33-34 (Com. Car. Bur. 1988) (U S West Order).

transactions would be divided into lines of business. An affiliate transaction would be eligible for prevailing company pricing only if it occurred within the same line of business as transactions with non-affiliates. Finally, the total company approach would permit prevailing company pricing whenever an affiliate transaction involved a nonregulated affiliate meeting the 75 percent test.

88. We invite comment on the relative merits of these approaches in comparison to the product-by-product approach implicit in the current rules. In this regard, we ask commenters to address how we might apply the various approaches to individual products or features that the providing affiliate does not sell to non-affiliates. We are particularly interested in comments regarding the methods carriers might use to determine the amounts to record for these products or features.

89. We also invite comment on whether we should further condition eligibility for prevailing company pricing when the 75 percent test is met for the nonregulated affiliate as a whole. While we believe that the 75 percent test would protect against most potential abuses, we invite commenters to discuss whether we should preclude prevailing company pricing for each individual product and feature for which the providing affiliate's sales to non-affiliates do not constitute at least a given portion, such as 25 percent, of its total sales of that product or feature. Finally, although we propose to eliminate the substantiality requirement, we invite comment on how we might define substantial under each of the approaches for determining eligibility for prevailing company pricing discussed above[82] in the event we retain that requirement.

C. Fair Market Value

90. The valuation methods we propose in this Notice would require carriers to estimate the fair market value of all non-tariffed affiliate transactions for which we do not permit prevailing company pricing. We believe that the procedures carriers use in estimating that value should vary with the circumstances of the transaction. Therefore, we do not intend to specify the precise steps carriers should include in each particular estimation process. Instead of specifying those steps, we propose to require carriers to attempt in good faith to determine whether fair market value exceeds cost when they provide assets or services to nonregulated affiliates and whether cost exceeds fair market value when they receive assets or services from nonregulated affiliates. If these attempts indicate that assets or services should be recorded at fair market value, we propose to require carriers to make additional efforts to define that value. We invite comment on this overall approach.

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[82] See para. 87, supra.

91. Despite this proposed overall approach, we believe there may be classes of affiliate transactions that lend themselves to a set of prescribed procedures for estimating fair market value. We invite the commenters to discuss whether this is so. For instance, if companies making certain kinds of purchases routinely solicit competitive bids, survey potential suppliers, or obtain independent appraisals, we may require carriers to adopt identical procedures.

92. We also invite comment on the role the prices the providing affiliate charges non-affiliates should play in the determination of fair market value. Although those prices do not necessarily establish fair market value,[83] we believe that the fair market value of assets and services carriers provide nonregulated affiliates is unlikely to fall below the prices carriers charge non-affiliates. We also believe that the fair market value of assets and services nonregulated affiliates provide carriers is unlikely to exceed the prices nonregulated affiliates charge non-affiliates.

D. Miscellaneous Requirements

1. Cost Allocation Manuals

93. As indicated previously, we require AT&T and LECs with annual revenues of at least $100 million to file cost manuals detailing their cost apportionment procedures.[84] Each of these manuals must include a chart showing all of the filing carrier's corporate affiliates.[85] Each manual must also identify the affiliates that engages or will engage in transactions with the carrier, and describe the nature, terms, and frequency of those transactions.[86] We propose below additional cost manual requirements that we believe may present cost-effective tools for ensuring compliance with the affiliate transactions rules, including any changes to those rules we adopt in this proceeding. We invite comment on these proposals and on whether any further changes to our cost manual requirements would help achieve our objectives in this proceeding.

94. The first new cost manual requirement that we propose concerns nonregulated operations within carriers that do not use

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[83] <u>See</u> para. 18, <u>supra</u>.

[84] <u>See</u> para. 7, <u>supra.</u>

[85] 47 C.F.R. §64.903(a)(3).

[86] 47 C.F.R. §64.903(a)(4).

resources jointly or in common with regulated operations.[87] In the Joint Cost Order, the Commission determined that these nonregulated operations should be subject to the affiliate transactions rules. The Commission, however, did not make clear whether cost manuals must include information regarding these nonregulated operations. We propose to clarify this area by requiring that cost manuals identify any such nonregulated operations. We also propose to require that the manuals provide information on these operations' affiliate transactions comparable to that which we require for other affiliate transactions.

95. Second, this Notice proposes to restrict prevailing company pricing to affiliate transactions involving nonregulated affiliates that sell at least 75 percent of their output to non-affiliates.[88] We propose to require carriers to state in their cost manuals which of their affiliates meet this test. These statements would have to be updated quarterly.

96. Third, although this Notice proposes to require carriers to use the prescribed interstate rates of return in determining the return component of affiliate transactions costs, we invite comment on alternatives to that proposal.[89] If we adopt any of those alternatives, we propose to require that each cost manual state the rate of return the subject carrier will use to calculate affiliate transactions costs.

97. Finally, our proposed valuation methods would require carriers to estimate the fair market value of all non-tariffed affiliate transactions for which we do not permit prevailing company pricing. In lieu of specifying procedures for carriers to use in estimating fair market value,[90] we propose to require that cost manuals describe the carriers' proposed procedures.

2. Independent Audits

98. Section 64.904(a) of our rules[91] requires each LEC that is required to file a cost allocation manual to obtain an independent audit annually. This audit must provide a positive opinion on whether the data shown in the carrier's annual joint

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[87] A structurally separate subdivision within a carrier might be such a nonregulated operation. See also paras. 104-106, infra.

[88] See para. 22, supra.

[89] See paras. 66-71, supra.

[90] See paras. 90-92, supra.

[91] 47 C.F.R. §64.904(a).

cost report[92] present fairly, in all material respects, the information required to appear in the report in accordance with the Joint Cost Orders and the Commission's rules in force as of the date of the auditor's report. We propose to amend this rule to make clear that the scope of the independent audit must encompass compliance with any requirements we adopt in this proceeding. We invite comment on this proposal.

3. Audit Trail

99. In the Joint Cost Order, the Commission stated that carriers would be expected to maintain a complete audit trail of all cost allocations and affiliate transactions.[93] The Commission, however, did not adopt any rule requiring that such an audit trail be maintained. We propose to incorporate an audit trail requirement into our rules. We invite comment on this proposal.

V. OTHER MATTERS

A. Applicability to IXCs

100. In the Joint Cost Order, the Commission determined that dominant IXCs, a group that consists of AT&T and Alascom, should be subject to the affiliate transactions rules. AT&T is required to file a cost allocation manual and to obtain an annual attestation audit.[94] Alascom is exempt from these requirements.[95]

101. Since the adoption of the affiliate transactions rules, we have adopted a price cap system for AT&T that imposes no sharing obligations.[96] This system greatly reduces the incentives that AT&T may have to shift costs between its nonregulated operations and its carrier operations. Since AT&T's price caps are unrelated to AT&T's current costs, attempts by AT&T to manipulate the costs it records for affiliate transactions will not increase AT&T's rates. Indeed, AT&T has often elected to set prices at levels below the price cap maximums. This below-cap pricing suggests competitive pressures on the rates AT&T can charge and limits on its ability to increase prices as a result of cost shifting. In view of these reduced incentives to shift costs, we invite comment

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[92] This report provides data on regulated and nonregulated usage of the USOA accounts used in calculating interstate costs. See 47 C.F.R. §43.21(f)(2).

[93] Joint Cost Order, 2 FCC Rcd at 1329, para. 242.

[94] 47 C.F.R. §64.903(a); Joint Cost Order, 2 FCC Rcd at 1328, para. 236.

[95] See Alascom Letter, supra n.12.

[96] AT&T Price Cap Order, 4 FCC Rcd at 2893-98, paras. 36-52.

on whether AT&T should be subject to each aspect of the system we propose for affiliate transactions.[97]

102. On May 17, 1993, the Alaska Joint Board tentatively recommended and invited comment on a new market structure for the provision of interstate telecommunications service between Alaska and the contiguous states and between Alaska and Hawaii.[98] In recommending a new structure, the Joint Board observed that the present structure is defined by a Joint Service Arrangement ("JSA") that requires AT&T to reimburse Alascom for the expenses it incurs in providing interstate message telephone service with AT&T to the extent Alascom does not recover them from its customers.[99] The Joint Board recognized that the JSA may give Alascom substantial incentives to impose nonregulated costs on interstate ratepayers and engage in imprudent transactions.[100] Although the Joint Board recommended that the JSA be terminated, we wish to ensure that any new market structure adopted for Alaska eliminates these incentives. Therefore, we propose to require Alascom to apply the valuation methods we propose in this proceeding. To ensure Alascom's compliance with those methods and with our cost apportionment requirements, we also propose to require Alascom to submit a cost allocation manual for Commission approval and to obtain an attestation audit. We invite comment on these proposals.

B. Applicability to Price Cap LECs

103. In contrast to the AT&T price cap system, the price cap system we adopted for LECs imposes extensive sharing obligations.[101] When we adopted this system, we scheduled a review of the LECs' performance under price caps for 1994.[102] In

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[97] We note that we recently determined that the AT&T price cap plan has worked well, combining reasonable rates and modest regulatory requirements with strong incentives for productivity growth and innovation. Price Cap Performance Review for AT&T, Report, 8 FCC Rcd 5165 (1993). We, therefore, proposed only minor modifications to that plan. Price Cap Performance Review for AT&T, Notice of Proposed Rulemaking, 8 FCC Rcd 5205 (1993).

[98] Integration of Rates and Services for the Provision of Communications by Authorized Common Carriers between the Contiguous States and Alaska, Hawaii, Puerto Rico and the Virgin Islands, Tentative Recommendation and Order Inviting Comments, CC Docket No. 83-1376, 8 FCC Rcd 3684 (Joint Bd. 1993) (Alaska Tentative Recommendation).

[99] See id. at 3684, para. 2.

[100] Id. at 3687, para. 26.

[101] LEC Price Cap Order, 5 FCC Rcd at 6835, paras. 397-98.

[102] Id. at 6834, para. 385.

promising this review, we stated that we would reevaluate the sharing mechanism as well as other aspects of the LEC price cap system. Although we believe that affiliate transactions rules are necessary to assist us in determining the LECs' sharing obligations,[103] we do not intend in this proceeding to prejudge the price cap LEC performance review. If we should decide in the LEC price cap review proceeding to alter the sharing mechanism, we can at that time reevaluate the appropriate extent to which the affiliate transactions rules should apply to the price cap LECs.

C. Applicability to Particular Kinds of Transactions

1. Parts of Carriers

104. Most nonregulated activities in which carriers engage involve the use of resources that the carriers also use to provide regulated products or services. In the Joint Cost proceeding, the Commission determined that all costs of these resources, including those incurred for nonregulated activities, should be recorded in the USOA accounts prescribed for telephone company operations. These accounts are referred to as regulated accounts.[104]

105. Carriers can also engage in nonregulated activities that do not use resources jointly or in common with regulated products or services. In the Joint Cost proceeding, the Commission created Account 7990, Nonregulated net income, for carriers to use to record these activities.[105] This account is a nonregulated account.

106. In the Joint Cost proceeding, the Commission determined that transactions between operations that record their costs in regulated accounts and operations that record their costs in nonregulated accounts should be subject to the affiliate transactions rules.[106] The Commission also determined that transactions between operations that record their costs in regulated accounts should not be subject to those rules.[107] We propose to continue these practices.

2. Transactions between Nonregulated Operations

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103 See note 14, supra.

104 47 C.F.R. §32.14(c).

105 47 C.F.R. §32.7990.

106 See Joint Cost Reconsideration Order, 2 FCC Rcd at 6296, para. 121; Joint Cost Order, 2 FCC Rcd at 1336, para. 298.

107 See Joint Cost Reconsideration Order, 2 FCC Rcd at 6296, para. 122.

107. When it adopted the affiliate transactions rules, the Commission intended to subject to those rules all transactions between operations that record their costs in regulated accounts and nonregulated affiliates.[108] Despite this intent, carriers have asserted that transactions between nonregulated affiliates and nonregulated operations within carriers that record their costs in regulated accounts are not subject to those rules. The carriers argue that such transactions do not affect interstate costs.

108. We believe, however, that such transactions affect interstate costs in two ways. First, as explained in the Bell Atlantic Review Order, the costs recorded in USOA accounts for transactions between these carrier operations and nonregulated affiliates affect the overall apportionment of costs between regulated and nonregulated activities.[109] Second, even when they are recorded in USOA revenue accounts but not the USOA cost accounts,[110] such transactions can be links in transactional chains that result in costs being recorded in USOA accounts.[111] Therefore, we propose to amend the affiliate transactions rules to make clear that they apply to transactions between nonregulated affiliates and nonregulated operations within carriers that record their costs in regulated accounts. We invite comment on this proposal.

3. Quantification

109. The proposed valuation methods would change the amounts carriers record in USOA accounts for affiliate transactions. We invite the commenters to quantify the impact each of those methods would have on regulated operations. We also invite carriers to quantify which of their nonregulated affiliates meet the 75 percent test we propose for determining eligibility for prevailing company pricing. To facilitate the development of a complete record in this proceeding, we hereby delegate to the Bureau our power to require carriers to quantify the potential effect of our proposals in this Notice.

VI. PROCEDURAL MATTERS

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[108] See Joint Cost Order, 2 FCC Rcd at 1336, para. 298; see also Bell Atlantic Review Order, 2 FCC Rcd at 2552, para. 9.

[109] Bell Atlantic Review Order, 2 FCC Rcd at 2552, para. 11.

[110] This happens when a nonregulated operation that records its activities in regulated accounts provides an affiliate transaction that does not involve the transfer of a resource that had been recorded in an investment account.

[111] See paras. 48-50, supra,

A. Ex Parte

110. This is a non-restricted notice and comment rulemaking proceeding. Ex parte presentations are permitted, except during the Sunshine Agenda period, provided they are disclosed as provided in the Commission's rules.[112]

B. Regulatory Flexibility

111. We certify that the Regulatory Flexibility Act of 1980 does not apply to this rulemaking proceeding because if the proposals in this proceeding are adopted, there will not be a significant economic impact on a substantial number of small business entities, as defined by Section 601(3) of the Regulatory Flexibility Act.[113] Those proposals concern the methods dominant IXCs and LECs use to account for affiliate transactions. These carriers are generally large corporations or affiliates of large corporations, are dominant in their fields of operation, and therefore are not "small entities" as defined by that act.[114] The Secretary shall send a copy of this Notice of Proposed Rulemaking, including the certification, to the Chief Counsel for Advocacy of the Small Business Administration in accordance with Section 605(b) of that act.[115]

C. Comment Dates

112. We invite comment on the proposals and tentative conclusions set forth above. Pursuant to applicable procedures set forth in Sections 1.415 and 1.419 of the Commission's Rules,[116] interested parties may file comments on or before December 10, 1993, and reply comments on or before January 10, 1994. To file formally in this proceeding, you must file an original and four copies of all comments, reply comments, and supporting comments. If you want each Commissioner to receive a personal copy of your comments, you must file an original plus nine copies. You should send comments and reply comments to Office of the Secretary, Federal Communications Commission, Washington, D.C. 20554. A courtesy copy should also be sent to William A. Kehoe III, Accounting and Audits Division, 2000 L Street, N.W., Washington, D.C. 20554. Comments and reply comments will be available for public inspection during regular business hours in the FCC

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112 See generally 47 C.F.R. §§1.1202, 1.1203, 1.1206(a).

113 5 U.S.C. §601(3).

114 See MTS and WATS Market Structure, 93 FCC 2d 241, 338-39 (1983).

115 5 U.S.C. §605(b).

116 47 C.F.R. §§1.415, 1.419.

Reference Center, Room 239, 1919 M Street, N.W., Washington, D.C. 20554.

VII. ORDERING CLAUSES

113. Accordingly, IT IS ORDERED that, pursuant to Sections 1, 4(i), 201-205, 218-220, and 403 of the Communications Act of 1934, as amended, 47 U.S.C. §§151, 154(i), 201-205, 218-220, and 403, NOTICE IS HEREBY GIVEN of proposed amendments to Parts 32 and 64 of the Commission's rules, 47 C.F.R. Parts 32 and 64, described in this Notice of Proposed Rulemaking.[117]

114. IT IS FURTHER ORDERED that the Chief, Common Carrier Bureau, SHALL HAVE DELEGATED AUTHORITY to require carriers to quantify the potential effect of our proposals in this Notice.

FEDERAL COMMUNICATIONS COMMISSION

William F. Caton

William F. Caton
Acting Secretary

[117] The appendix to this Notice sets forth the text of proposed rules. That text also corrects several typographical errors in the existing rules.

APPENDIX--PROPOSED RULES

Parts 32 and 64 of the Commission's Rules and Regulations, 47 C.F.R. Parts 32 & 64 are proposed to be amended as follows:

1. The authority citation for Part 32 is amended to read as follows:

Authority: Secs. 4 and 220, 48 Stat. 1066, as amended; 47 U.S.C. 154 and 220, unless otherwise noted. Interpret or apply secs. 1, 201-205, 218-220, and 403, as amended, 47 U.S.C. 151, 201-205, 218-220, and 403, unless otherwise noted.

2. Section 32.23 is amended by revising paragraph (b) to read as follows:

§ 32.23 Nonregulated Activities.

* * * * *

(b) When a nonregulated activity does not involve the joint or common use of assets or resources in the provision of both regulated and nonregulated products and services, carriers shall account for these activities on a separate set of books consistent with instructions set forth in §§ 32.1406 and 32.7990. Transactions between an activity for which a separate set of books is maintained and an activity for which a separate set of books is not maintained shall be accounted for in accordance with § 32.27. In the separate set of books, carriers may establish whatever detail they deem appropriate beyond what is necessary to provide this Commission with the information required in §§ 32.1406 and 32.7990.

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3. Section 32.27 is amended by revising paragraphs (a) through (d) to read as follows:

§ 32.27 Transactions with Affiliates.

(a) Unless otherwise approved by the Chief, Common Carrier Bureau, transactions with nonregulated affiliates involving transfers into or out of the regulated accounts shall be recorded by the carrier as provided in paragraphs (b) through (f) of this section.

(b) Affiliate transactions provided pursuant to tariffs that are generally available, on file with a federal or state agency, and in effect shall be recorded at tariffed rates.

(c) Affiliate transactions that are not required to be recorded at tariffed rates shall be recorded at prevailing company prices if and only if:

(1) The transactions are with nonregulated affiliates that sell at least 75 percent of their output to non-affiliates, and

(2) Any other conditions specified by Commission order are met.

(d) All other affiliate transactions shall be recorded at either cost or estimated fair market value in accordance with the following conditions:

(1) Sales to nonregulated affiliates shall be recorded at the higher of cost and estimated fair market value.

(2) Purchases from nonregulated affiliates shall be recorded at the lower of cost and estimated fair market value.

(3) In calculating the costs of affiliate transactions, carriers shall comply with the procedures specified by Commission order.

(4) In estimating the fair market value of affiliate transactions, carriers required to file cost allocation manuals shall comply with the procedures set forth in those manuals.

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4. The authority citation for Part 64 is amended to read as follows:

Authority: Secs. 4, 48 Stat. 1066, as amended; 47 U.S.C. 154, unless otherwise noted. Interpret or apply secs. 1, 201-205, 218-220, 225-227, and 403, 48 Stat. 1070, as amended, 47 U.S.C. 151, 201-205, 218-220, 225-227, and 403, unless otherwise noted.

5. Section 64.903 is amended by revising paragraphs (a)(3) and (a)(4), adding paragraph (a)(5), renumbering former paragraphs (a)(5) and (a)(6), and revising paragraphs (b) and (c) to read as follows:

§ 64.903 Cost allocation manuals.

(a) * * *

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(3) A chart showing all of the carrier's corporate affiliates including any operations within the carrier that engage in nonregulated activity that does not involve the joint or common use of assets or resources in the provision of both regulated and nonregulated products and services;

(4) A statement **listing** each affiliate that engages in or will engage in transactions with the carrier, identifying which, if any, of the listed affiliates sells at least 75 percent of its output to non-affiliates, and describing the nature, terms and frequency of each transaction.

(5) A description of the carrier's procedures for estimating the fair market value of affiliate transactions.

(6) A cost apportionment table showing, for each account containing costs incurred in providing regulated services, the cost pools within that account, the procedures used to place costs into each cost pool, and the method used to apportion the costs within each cost pool between regulated and nonregulated activities; and

(7) A description of the time reporting procedures that the carrier uses, including the methods or studies designed to measure and allocate nonproductive time.

(b) Each carrier shall ensure that the information contained in its cost allocation manual is accurate. Carriers must update their manuals at least quarterly, except that changes to the cost apportionment table and to the description of time reporting procedures must be filed at least 60 days before the carrier plans to implement the changes. Proposed changes in the description of time reporting procedures, the statement concerning affiliate transactions, and the cost apportionment table must be accompanied by a statement quantifying the impact of each change on regulated operations. Changes in the description of time reporting procedures and the statement concerning affiliate transactions must be quantified in $100,000 increments at the account level. Changes in cost apportionment tables must be quantified in $100,000 increments at the cost pool level. The Chief, Common Carrier Bureau, may suspend any such changes for a period not to exceed 180 days, and may thereafter allow the change to become effective or prescribe a different procedure.

(c) The Commission may by order require any other communications common carrier to file and maintain a cost allocation manual as provided in this section.

6. Section 64.904 is amended by revising paragraph (a) to read as follows:

§ 64.904

(a) Each local exchange carrier required by this part or by Commission order to file a cost allocation manual shall have performed annually, by an independent auditor, an audit that provides a positive opinion on whether the applicable data shown in the carrier's annual report required by § 43.21(f)(2) of this chapter presents fairly, in all material respects, the information of the carrier required to be set forth therein in accordance with the carrier's cost allocation manual, the Commission's Joint Cost Orders issued in conjunction with CC Docket No. 86-111 and Affiliate Transactions Orders issued in conjunction with CC Docket No. 93-251, and the Commission's rules and regulations including sections 32.23, 32.27, 64.901 and 64.903 in force as of the date of the auditor's report. The audit shall be conducted in accordance with generally accepted auditing standards, except as otherwise directed by the Chief, Common Carrier Bureau.

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